MALAYAN WEAVING MILLS SDN BHD

v.

DIRECTOR GENERAL OF INLAND REVENUE

HIGH COURT MALAYA, JOHOR BAHRU
ZAINUN ALI J
[CIVIL APPEAL NO: 14-01-1997]
23 APRIL 1999

REVENUE LAW: *Income tax - Deduction - Provisions for payment of retirement benefits - Whether wholly and exclusively incurred in the production of gross income - Whether retirement benefits only a prospective liability - Whether a capital expenditure - Whether deductible - Whether to allow a deduction now would result in uncertainties - Income Tax Act 1967, s. 33(1)*

REVENUE LAW: *Income tax - Deduction - Distinction between capital and revenue expenditure - How should court approach this issue - General test of deductibility - Whether expenditure must be incurred during the relevant basis period - Expenditure which will only be incurred in future - Whether deductible - Income Tax Act 1967, ss. 33(1) & 39*

REVENUE LAW: *Income tax - Assessment - Treatment of accounts by taxpayer - Whether conclusive for Inland Revenue in arriving at a decision - Whether not relevant in deciding if a claim for expense should be allowed as deduction*

The appellant sold its dyeing and printing mill to Textile Corporation (Malaysia) Sdn Bhd ('TCM') and transferred all its employees working in the said dyeing and printing mill to TCM. The provisions for retirement benefits for these employees were adjusted and finalised at a figure of RM1,885,529 which was set off against the actual sale price to TCM. No employee was due to retire or due to receive the benefits on account of retirement at the time of the sale. The appellant, contending that the provisions for retirement benefits were tax deductible under s. 33(1) of the Income Tax Act 1967 ('the Act') as an expense wholly and exclusively incurred in the production of the appellant's gross income, claimed the said amount should be deducted for purposes of calculating income tax payable. The respondent disallowed the deduction and the appellant's appeal to the Special Commissioners of the Income Tax was dismissed. This was the appellant's appeal by way of case stated. The issue before the court was whether the provisions for retirement benefits qualify for deduction in computing the adjusted income of the appellant.

Held:

[1] The general rule is that no deduction may be claimed in respect of expenditure which is capital rather than revenue in nature. The distinction between the two categories of expenditure, however, is one that is difficult to ascertain in many cases. The determination of the various factors on the basis of which a court will reach its balanced opinion is a question of fact. However, whether the item is a revenue or a capital item, on the basis of those factors, is a question of law. The nature of the payment made is not to be judged by the subjective test of the intentions of those who actually made the payments but by the nature and effect of the payment made and the benefits which are obtained in return for it. Further, in considering whether a particular item of expenditure is deductible for tax purposes, the problem should be looked at from the point of view of the payer and not the payee because payments which are income receipts in the hand of the recipient are not necessarily revenue expenditure in the hands of the payer.

[2] What amounts to an expense "wholly and exclusively incurred during that period in the production of income" will have to be determined on the facts of each case. The starting principle is what is the nature and ordinary course of business and the objects for which the expenditure is incurred. It thus becomes critical to consider whether the expenditure is incurred for the purpose of business and naturally this question is to be viewed in the larger context of business expediency. The general test of deductibility is that all outgoings and expenses must be incurred during the relevant period wholly and exclusively in the production of income and which is not prohibited by s. 39 of the Act. Thus, to be deductible, the expenditure must not only be wholly and exclusively incurred in the production of the gross income, but it must also be incurred during that period, meaning the relevant basis period.

[3] Where there is an absolute liability to pay at the end of the year in which the provision is made, the expenditure is deductible. On the other hand, where a provision is made for expenditure which will crystallise only in a period subsequent to the accounting period under review, the expenditure does not rank for deduction.

[4] In the instant case, the retirement benefits were actually a liability which is prospective or contingent until the employee retires or becomes entitled to the retirement benefits under the term of employment. Until such time, the appellant was under no liability to pay. There was nothing in the accounts to show that the retirement benefits were incurred during that period wholly and exclusively in the production of the appellant's gross income. Thus, the provisions did not qualify for deduction.

[5] To satisfy the word "incurred" in s. 33(1) of the Act, the liability must be actually incurred and due, though not yet disbursed or discharged. In the instant case, the amount claimed as deduction was not by way of payment to the employees for whom it was actually meant. It was merely a provision which may or may not be incurred in full or in part at a later date.

[6] The situation in the instant case gives rise to uncertainties such as whether the appellant was entitled to claim another deduction when the retirement benefits were actually paid out as and when the employees retire, or when they resign or die; and whether if a deduction is available now, what happens if employees forfeit their retirement benefits in the event of dismissal for misconduct or dishonesty. In view of the uncertainties and the possible claims for double or more deductions and the administrative difficulties of keeping track of the various deductions, the deduction should be allowed when the appellant as a taxpayer is under a definite obligation to pay and does pay in that year.

[7] The amount in question forms part of the cost of sale of the mill to TCM and therefore constitutes a capital expenditure rather than a revenue expenditure. In the final analysis, the appellant had not satisfied the ingredients of s. 33(1) of the Act as to qualify for a deduction.

Per curiam:

[1] The treatment of the accounts by a taxpayer is not relevant in deciding whether a claim for expense should be allowed as a deduction. The accounts and the accounting treatment given should not detract the respondent from their true path in deciding tax issues, however reputable or eminent the accountants may be, since the method of keeping accounts is essentially a guide which should not be conclusive or determinative for the respondent in arriving at its decision.

[Appeal dismissed.]

Case(s) referred to:

Ampat Tin Dredging v. DGIR [1950-85] MSTC 429 ***(refd)***
Bombay Steamship Navigation Co v. CIT AIR [1965] SC 1201 ***(refd)***
British Insulated & Helsby Cables Ltd v. Atherton [1926] AC 205 ***(refd)***
Commissioner of Inland Revenue v. Cosmotron Manufacturing Co Ltd [1997] STC 1134 ***(dist)***
Commissioner of Inland Revenue v. Lo & Lo [1984] STC 366 ***(dist)***
DGIR v. Kulim Rubber Plantation Ltd [1950-85] MSTC 232 ***(refd)***
DGIR v. LCW [1975] 1 MLJ 250 ***(refd)***
Heather v. PE Consulting Group Ltd 48 TC 293 ***(refd)***
I Investment Ltd v. CGIR [1975] 2 MLJ 212 ***(refd)***

Nilsen Development Laboratories Pty Ltd & Ors v. Federal Commissioner of Taxation [1981] ATC 4031 ***(refd)***
Ralli Estate Ltd v. Income Tax Commissioners [1961] 1 WLR 329 ***(refd)***
Southern Railway of Peru v. Owen [1957] AC 344 ***(foll)***
Syarikat KM v. DGIR (FC) [1950-85] MSTC 332 ***(refd)***

Legislation referred to:
Income Tax Act 1967, ss. 33(1), 39

Inland Revenue Ordinance 1956 [Hong Kong], s. 16(1)

For the applicant - Anand Raj; M/s Shearn Delamore & Co
For the respondent - Zaleha Adam; Inland Revenue Department

Reported by S Dharmendran

JUDGMENT

Zainun Ali J:

This is an appeal by way of case stated by the appellant against the decision of the special commissioners of the income tax (hereinafter referred to as "SCIT") made on 5 July 1997, that the provision made for retirement benefits that had been taken into account in the sale of the appellant's dyeing and printing mill was not an allowable deduction under s. 33(1) of the Income Tax Act 1967 (hereinafter referred to as "the Act").

Briefly the facts of this case is that prior to 1 November 1989, the appellant owned and operated three types of mills namely a spinning mill, two weaving mills and a dyeing and printing mill. The appellant subsequently sold the dyeing and printing mill to Textile Corporation (Malaysia) Sdn Bhd (hereinafter referred to as "TCM") in order to rationalise the business and to qualify for pioneer status under the Promotion of Investment Act 1987 whereby it is exempted from payment of income and development taxes.

The appellant then transferred all its employees working in the said dyeing and printing mill to TCM. The provisions for retirement benefits for these employees was adjusted and finalised at a figure of RM1,885,529 which was set-off as against the actual sale price to TCM. The respondent disallowed the appellant's claim that the provision for retirement benefits were tax deductible as an expense wholly and exclusively incurred in the production of the appellant's gross income.

It needs to be emphasised that the appellant is one of the three textile factories in the same groups, the other two being TCM and MWM Enterprise Sdn Bhd. At the time of the sale both MWM and TCM were owned by the same three

shareholders. Also no employee was due to retire or due to get the benefits on account of retirement at the time of sale.

This court acknowledges that in an appeal by a taxpayer to the SCIT against an assessment made under the Act, the assessment stands unless the taxpayer is able to satisfy the SCIT that the assessment is overcharged. It follows, that in such an appeal the onus is on the taxpayer to demonstrate that the assessment should not have been made, and so, the assessment stands unless and until the taxpayer satisfies the SCIT that the assessment made by it is wrong. The taxpayer, therefore, undertakes the same onus when he brings a further appeal to the High Court.

The SCIT had dismissed the appellant's appeal by holding that provisions made by the appellant for retirement benefits (which were later transferred by the appellant to the purchaser (TCM) of the appellant's dyeing and printing mill) could not be deducted as a revenue expense of the appellant under s. 33(1) of the Act.

Needless to say, if the retirement benefits are allowed as a deduction under s. 33(1) of the Act, the amount of the appellant's income chargeable to tax would be reduced. It is the appellant's argument therefore, that the SCIT wrongfully disallowed the deduction of what, in law, amounted to an actual payment of revenue expenses (the retirement benefits) in the computation of the appellant's income tax in dispute.

Thus in order for the appellant to qualify for such deduction, the expense must constitute an expense which is a revenue expense or 'business' expense as opposed to a capital expense.

The general rule remains that no deduction may be claimed in respect of expenditure which is capital rather than revenue in nature.

The distinction between the two categories of expenditure is one, however, that is difficult to ascertain in many cases. While the determination of the various factors on the basis of which a court will reach its balanced opinion is a question of fact, whether the item is on the basis of those factors, a revenue or a capital item is a question of law. The nature of the payment made is not to be judged by the subjective test of the intentions of those who actually made the payments but by the nature and effect of the payment made and the benefits which are obtained in return for it.

This court is reminded of the case of *I Investment Ltd v. CGIR* [1975] 2 MLJ at p. 212 where Raja Azlan FJ (as His Lordship then was) referred to a passage from the judgment of Lord Denning in *Heather v. PE Consulting Group Ltd* 48 TC 293, 322, that:

> The courts have always been assisted greatly by the evidence of accountants. Their practice should be given due weight: but the courts have never regarded themselves as being bound by it. The question of what is capital and what is revenue is a question of law for the courts.

Perhaps at this point I should refer to one of the early and often quoted statements illustrating the character of capital expenditure made by Viscount Cave LC in *British Insulated and Helsby Cables Ltd v. Atherton* [1926] AC 205. His Lordship said:

> But when an expenditure is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is a very good reason (in the absence of special circumstances leading to the opposite conclusion) for treating such an expenditure as properly attributed not to revenue but to capital.

In that case, a lump sum paid by the company to establish a pension scheme for its staff was held not to be admissible as a deduction based on the enduring benefit test enunciated by Viscount Cave LC. The initial contribution made by the company was held to be of a capital nature in that its incurrence had created an advantage of enduring benefit to the company. It was held that the object and effect of the payment was to enable the company to establish the pensions fund and to offer to existing and future staff a sure provision for their old age, thereby obtaining for the company the substantial and lasting advantage of being able to secure and retain the services of a contented and efficient staff.

Another aspect that should not be overlooked is the fact that many types of payment are deductible to the payer but not so in the hands of the recipient and *vice versa*. To quote a simple example, if a trading company purchases a computer for its use from a computer dealer the payment by the trading company is a capital expenditure although the sale by the dealer is a taxable receipt (revenue expenditure). Hence, in considering whether a particular item of expenditure is deductible for tax purposes the problem should be looked at from the point of view of the payer, not the payee. Lord Denning in delivering the judgment of the Privy Council in *Ralli Estate Ltd v. Income Tax Commissioners* [1961] 1 WLR 329 stated, "Payments which are income receipts in the hand of the recipient are not necessarily revenue expenditure in the hands of the payer". A similar analogy can be drawn with respect to the retirement provisions in the hands of the appellant as compared to it being with TCM.

The appellant however contends that the provisions of s. 33(1) of the Act had been satisfied on the facts and that it does not require the employee to actually receive the retirement benefits and that the appellant need only to "incur" the expenses.

For the sake of completeness, it would be pertinent to state s. 33(1) of the Act, which reads as follows:

> 33(1) Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source, including -

Thus the crucial elements in s. 33(1) that need to be scrupulously satisfied would necessarily encompass "outgoings and expenses", "wholly and exclusively", "incurred during that period", "in the production of income".

When the provision for retirement benefits was adjusted and finalised to RM1,885,529, the respondent raised two notices of additional assessment charging the appellant to tax in the amount of RM1,398,219.50 in all, for the year of assessment 1991.

Of the total tax payable by the appellant as indicated above, RM631,853.36 relates to the disallowance of the retirement benefits transferred by the appellant and which is now the subject of this appeal.

In fact the final purchase price for the sale of the dyeing and printing will by the appellant to TCM was a reduced purchase price after taking into account the liabilities assumed by TCM and setting off those liabilities against the value of the assets sold by the appellant to TCM pursuant to the sale & purchase agreement.

The Appellant's Case

It is the appellant's case that:

(a) The provision for retirement benefits made by the appellant and which was transferred upon the sale of the appellant's dyeing and printing mill, is deductible as an expense wholly and exclusively incurred in the production of the appellant's gross income for the Year of Assessment 1991;

(b) That the appellant was bound to pay out retirement benefits to its employees under the collective agreement between the employees and the appellant;

(c) That the appellant had made detailed annual provisions for its employees in accordance with the relevant formulae prescribed for the computation of retirement benefits;

(d) That it was not only an expense incurred by the appellant, it was actually "paid out" in the sense that the consideration for the purchase of the mill would have been far higher than what was received, if the liability for retirement benefits had not been taken into account in computing the purchase price;

(e) That the final provision for retirement benefits "crystallised" in the amount of RM1,885,529 at the time the purchase price was finalised in accordance with cl. 4(3) of the sale and purchase agreement.

The appellant had relied on the case of *Commissioner of Inland Revenue v. Lo & Lo* [1984] STC 366 and argued that:

(i) an expense is not confined to a disbursement;

(ii) even mere provisions in the accounts were held to be an expense incurred.

The appellant also quoted the House of Lords decision in *Southern Railway of Peru v. Owen* [1957] AC 344 and submitted that "annual provisions could be set-off against the annual receipts of a company provided the future payments could be fairly estimated".

The Respondent's Reply

In opposing the appellant's case, the respondent firstly contends that the Hong Kong case of *Commissioner of Inland Revenue v. Lo & Lo* above is not applicable in the instant case as the relevant section, ie, s. 16(1) of the Hong Kong Inland Revenue Ordinance 1956 is markedly different from our s. 33(1) of the Act.

Section 16(1) of the Hong Kong Ordinance reads:

> "16(1) In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period of that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part **for any period**, including ... (Emphasis is mine).

Thus the Hong Kong law provides for "any period" which is not the case in our s. 33(1) where the language is more confining and restrictive, couched as it were in the words, "during that period".

The respondent submits therefore that s. 33(1) of the Act clearly provides that only expenses which are incurred during that period is allowed as deduction.

The respondent went on further to submit that the principles expressed in the House of Lords decision in *Southern Railway of Peru Ltd v. Owen* is more persuasive.

In *Owen*, which was decided by the House of Lords,

> a company trading in Peru was obliged by statute to pay certain sums to its employees on their retirement. The sum was calculated by taking a proportion of their last year's salary and by multiplying the number of years of service, unless the employee was dismissed for misconduct. The taxpayer company made a provision for this future liability in its accounts. The House of Lords was of the opinion that in principle the deduction was permissible, but that the actual provision was not determined and, therefore not allowed. In other words, a deduction is permissible where a taxpayer is under a definite obligation to pay his employees for the services in that year and also a future payment in some subsequent year.

(Taken from *Malaysian Tax Reporter*, para. 10-050, p. 8141 CCH Asia vol. 1).

Thus the respondent went on to submit that in order to be eligible for a deduction under s. 33(1) of the Act, the appellant should satisfy the ingredients of that section, which the appellant has failed to do.

It is also the respondent's contention that the benefits become payable only if and when the employees retire or resign. For as long as the employees remain employed, they are not entitled to such benefits. The respondent went on to submit that the mere provision for the benefits does not constitute a revenue expenditure and that the benefits were not due and payable at the time the provisions were made by the appellant in the accounts.

The respondent submitted further that the appellant will be entitled to deduction as and when the benefits are paid in each year. The respondent submitted that the set-off of the provision against the purchase price is a **capital expenditure** which does not rank for deduction.

Having considered the evidence adduced by both parties I have this to say:

The language of s. 33(1) of the Act is more constrained and is narrower than that of s. 16(1) of the Hong Kong Act, favoured by the appellant in the *Lo & Lo* case.

It is of course commonplace that what amounts to an expense "wholly and exclusively incurred during that period in the production of income" will have to be determined on the facts of each case as per *Syarikat KM v. DGIR* (FC) [1950-85] MSTC 332 (p. 114 AA), *Bombay Steamship Navigation Co. v. CIT AIR* [1965] SC 1201 (p. 119 ABA) and *Ampat Tin Dredging v. DGIR* [1950-85] MSTC 429 (p. 233 ABA) HC.

The expression "expenses wholly and exclusively incurred in the production of gross income" are also frequently referred to as "revenue expenses" or "tax deductible expenses". In short, these descriptions are synonymous with each other.

In looking at the appellant's submission that on the specific facts of this case, the expenses incurred were business expenses utilised in retaining the services of the taxpayer's employees in the business and are therefore deductible, it is endemic to get to the starting principle, that is, what is the nature and ordinary course of business and the objects for which the expenditure is incurred.

It thus becomes critical to consider whether the expenditure is incurred for the purpose of business and naturally this question is to be viewed in the larger context of business expediency.

The general test of deductibility is that all outgoings and expenses must be incurred during the relevant period wholly and exclusively in the production of income and which is not prohibited by s. 39 of the Act.

Thus to be deductible, the expenditure must not only be wholly and exclusively incurred in the production of the gross income, it must also be incurred during that period, meaning the relevant basis period.

The appellant cited two authorities, ie, *DGIR v. Kulim Rubber Plantation Ltd.* 1950-85 MSTC 232 (p. 240 ABA) and *Commissioner of Inland Revenue v. Cosmotron Manufacturing Co. Ltd.* [1997] STC 1134 (p. 215 ABA), to illustrate the point that compensation and severance payments which employers are contractually obliged to make were held by the Malaysian Federal Court and the Privy Council respectively, to be revenue payments and were therefore tax deductible in favour of the taxpayer.

However, it is observed that the *Cosmotron* case is inappropriate since this is an appeal from Hong Kong where it had been found that the law as regards the deductibility of expenses is different and in any event, the facts of the case are distinguishable. In *Cosmotron,* the severance payments had been made to the employees for the purpose of discharging them and closing down the business. The company had carried out a contractual obligation to pay the employees, whereas in the instant case, the proper recipient of the retirement benefits as per the contract are the **employees** and not TCM.

The question of whether the appellant had actually "incurred" any expenses related to retirement benefits at the point of sale needs to be carefully examined, in view of the fact that no employee was due to retire at that point of time ("incurred during that period").

Furthermore, the provisions of the retirement benefits calculated from the collective agreement dated 16 November 1988 and the various contracts of employment only become payable when the employee actually retires. Where there is an absolute liability to pay at the end of the year in which the provision is made, the expenditure is deductible. Included in this category are as adverted to earlier, *ie*, directors' fees, commissions, etc. On the other hand, where a provision is made for expenditure which will crystallise only in a period subsequent to the accounting period under review, the expenditure does not rank for deduction. And undoubtedly, provisions for retirement benefits as in the instant case, would fall under this category.

Thus I subscribe to the decision of *Owen's* case where the House of Lords, whilst agreeing that in principle that such deduction was permissible, nevertheless stated that where the provisions were not determined, such deductions were not allowed. Some of the pertinent reasons advanced by Lord Radcliffe in *Owen's* case and which were agreed to by the other Law Lords except Lord MacDermott were that:

(a) There were many difficulties in ascertaining eventual liability;

(b) The employees might forfeit their rights to receive the benefits on account of dismissal etc; and

(c) The form and scale of the benefits might change.

The appellant had pressed home the point that it had made detailed breakdown of the provision which the SCIT had failed to consider. The appellant argued that even *Owen's* case does require only that the retirement benefits could be "satisfactorily determined or fairly estimated". Hence it is argued, a lower standard is required by *Owen* and *Lo & Lo*.

The appellant argued that the expenses were not incurred. It was actually "paid out" as the consideration for the purchase of the mill would have been far higher than what was finally received, if the liability for retirement benefits had not been taken into account in computing the purchase price.

I am of the view that the detailed breakdown of the retirement benefits tendered by the appellant is actually a liability which is prospective or contingent **until** the employee retires or becomes entitled to the retirement benefits under the term of employment. In fact, until such time, the appellant is under no liability to pay.

I would agree with Jenkins LJ in the Court of Appeal at p. 36 TC 602 in *Owen's* case that:

> ... The principle justifying the deduction is I think, only applicable as far as liabilities are concerned where both the following conditions are satisfied, namely:
>
> (i) the liability must be certain, not contingent ...
>
> (ii) the benefit, in respect of which the liability is incurred, must be exclusively **referable to the year in which it is sought to debit the liability as an expense** or in other words where as in the present case, the benefit consists of services, the liability must be an obligation incurred in that year exclusively in respect of services rendered during that year. (The emphasis is mine).

The appellant argued that though the annual statutory accounts of the appellant and the TCM do not bind the respondent, however in the absence of contrary evidence, the accounts may be relied upon in determining the appellant's chargeability to tax and should not have been disregarded outright by the SCIT.

At the risk of being repetitive, the accounts of both the appellant and TCM clearly showed that mere provisions for retirement benefits were made in the accounts and were not paid out. There is really absolutely nothing in the accounts to show that the retirement benefits were incurred during that period wholly and exclusively in the production of the appellant's gross income. The entire provision charged out in the accounts of appellant in the year ended 30 June 1990 is part of the cost of sale of the mill to TCM, and needless to say, this provision does not qualify for deduction.

There is no dispute that the appellant had discharged this liability. This has subsequently been assumed by TCM in the balance sheet for the year ended 31 March 1990. In fact, this virtually means a transfer of the liability from the appellant to TCM, pursuant to the sale and purchase agreement.

I will now make an observation as regards the issue of reliance upon the accounts of the taxpayer (appellant) and the purchaser (TCM).

It is observed that the fact that the appellant had reflected the provisions for the benefits in its annual accounts is neither here nor there, for it does not bind the respondent in assessing the tax payable.

In fact, the treatment of the accounts by a taxpayer is not relevant in deciding whether a claim for expense should be allowed as a deduction.

In this regard it would be helpful to remember the observation of His Lordship Lee Hun Hoe CJ (Borneo) (as he then was) in *DGIR v. LCW* [1975] 1 MLJ 250 where His Lordship said:

> For, however genuinely the accounts may have been framed by those responsible for them and however carefully they may have been studied by those responsible for auditing them, the other evidence may show that in fact they do not truly indicate the nature of the relevant operation.

It is my view that the accounts and the accounting treatment given should not detract the respondent from their true path in deciding tax issues, however reputable or eminent the accountants may be, since the method of keeping accounts is essentially a guide which should not be conclusive or determinative for the respondent in arriving at its decision.

The SCIT also referred to s. 51(1) of the Australian Income Tax which is more in line with s. 33(1) and in the case of *Nilsen Development Laboratories Pty Ltd & Ors v. Federal Commissioner of Taxation* [1981] ATC 4031 the Full High Court upheld the decision of the Federal Court in rejecting a taxpayer's claim for deduction in respect of a provision in its financial accounts representing an estimate of what it would be bound to pay the employees if they had been on leave during the year of income. The Full High Court held:

> No deduction under section 51(1) in respect of annual or long service leave of any amount can properly be claimed by an employer bound by an award or industrial agreement substantially in terms of the present awards until the employee takes the leave (or events occur such as death, termination of employment in certain circumstances, by reason of which the employer is bound to make the payments). Then, and only then, and for the first time, there is a present liability to pay money and then, and only then, there is an outgoing which is deductible under the provisions of section 51(1).

Barwick, CJ *inter alia*, said:

> Of course, it may very well be that in the keeping of commercial accounts it would be proper to make provisions against the annual gross profits of some sum related to the amount of the liability which must in due course arise because of the service by the employee during the year of accounting; and to do so before arriving at the profits or gains of the period during which the qualification of the employee is taking place. But the prudence and commercial propriety of such a course has little bearing on the question whether there is present in the year of income a loss or outgoing within the meaning of sec. 51(1).

In view of the uncertainties and the possible claims for double or more deductions and the administrative difficulties of keeping track of the various deductions, I am in complete agreement with SCIT's view that deductions be allowed only when the taxpayer is under a definite obligation to pay and does pay in that year.

Thus in order to satisfy the word "incurred" in s. 33(1) of the Act, the liability must be actually incurred and due, though not yet disbursed or discharged. In this case the amount claimed as deduction was not by way of payment to the employees for whom it was actually meant. It is merely a provision which may or may not be incurred in full or in part at a later date.

The situation as it were, begs several questions, such as whether the appellant is entitled to claim another deduction where the retirement benefits were actually paid out as and when the employees retire eventually, or when they resign or die; and if a deduction is allowed now, what happens if employees forfeit their retirement benefits in the event of dismissal for misconduct or dishonesty etc?

Thus the uncertainties as are manifest above can only mean that the deduction should only be allowed when the appellant as taxpayer is under a definite obligation to pay and does pay in that year.

It might also be observed that the sale of any company will take into account the liabilities before the sale price can be determined, including trade creditors, bank overdrafts, short term borrowings and provisions for retirement benefits. These items form part of the components to determine the sale price. In this case, the appellant had not only taken into account the provision for retirement benefits to determine the sale price, it had also claimed the said amount as a revenue expense in the tax computation for the year of assessment 1991.

On that basis I can come to only one conclusion, and that is, that this amount forms part of the cost of sale of the mill to TCM and therefore constitutes a capital expenditure rather than a revenue expenditure.

In the final analysis, I find that the appellant had not satisfied the ingredients of s. 33(1) of the Act as to qualify for a deduction. It is obvious that the provision reflected in the accounts is in fact part of the purchase price of the mill, and the transfer to TCM is in fact a transfer of a capital liability which will have to be met by TCM in the future. As had been alluded to earlier in this judgment, in considering whether a particular item of expenditure is deductible for tax purposes, the problem should be looked at from the point of view of the payer, not the payee. Thus when the time comes, it is TCM which will be entitled to the deduction as and when the benefits are paid.

Based on the above, I dismiss this appeal with costs and the decision of the Special Commissioners of the Income Tax (SCIT) is hereby affirmed.